



Preparing the ground for successful supply chain outsourcing

**Prepared by Martin Williams, Director, Bisham Ltd
For the
Outsourcing and Procurement Forum**

**Published by
The Chartered Institute of Logistics and Transport (UK)
Logistics and Transport Centre
PO Box 5787
Corby
Northants
NN17 4XQ**

This document may be photocopied as necessary for convenient use within a CILT member's organisation only but may not be further copied, nor reproduced nor transmitted electronically, without the written permission of the author.

Contents

1.0 Preparing the ground

- 1.1 Why is outsourcing being considered?**
- 1.2 The usual reasons**
- 1.3 What will be outsourced?**
- 1.4 What experience do we have**
- 1.5 Building a business case**
- 1.6 Change Management**
- 1.7 A history of failures**
- 1.8 Measuring success**
- 1.9 Checklist**

Background

The case for outsourcing, particularly the outsourcing of business processes that directly interface with your customers, needs careful thought and meticulous planning. A full analysis of the possible risks and an on-going commitment to the agreed strategy and overall direction of the outsourced area are also required. Not fully engaging in any of these activities will probably ensure that the outsourcing results will be less than optimal.

This document prepares the ground and leads you through the tender process for the outsourcing of logistics services.

This paper has been produced under the auspices of the Outsourcing and Procurement Forum of the CILT and the author would like to thank those members of the Forum who assisted in its production.

The Role of the Forum is:-

- To initiate original thinking and discussion in areas of outsourcing and procurement, relating to supply-chain.
- To produce papers and reports and set up events and workshops on subjects identified by the membership of the forum and other CILT(UK) members.
- To work with the regions through two-way communications process.
- To assist the regions in the identification of key supply-chain and transport issues and facilitate the development of responses.
- To assist the regions in setting up local O&P Forum, thus involving a greater proportion on the membership.

Bisham Consulting is one of the UK's fastest growing independent supply change consulting firms. It has been providing practical logistics solutions to manufacturers, retailers, third party logistics and distributors for more than 12 years. For more details see www.bishamconsulting.com

Martin Williams has been working in the logistics field since the mid 1970's. He has held senior management or board level positions for some of the major global logistics and container shipping companies. He has lived and worked extensively abroad, including the USA, Japan, Netherlands and Norway. He has been a director of Bisham for 3 years.

1.0 Preparing the ground

1.1 Why is outsourcing being considered?

This is the first question to be answered. Often the answer is that the decision has been made as part of corporate policy. But this is no real answer. The case for outsourcing must be made and reasons articulated. Have the relevant stakeholders' views and opinions been sought and taken into account? Has the impact on people and functions been determined? Is it a senior management diktat or has a team been set up to explore all issues and opportunities?

A 'diktat', unless a strong case already exists and has been well communicated, will fail through lack of clear objectives, reasons, lack of buy-in and ultimately the ownership of the final actions and their results.

A much better starting point is a senior management vision to outsource with high-level objectives. It is then best to establish a team, perhaps with external support, to investigate the issues and prepare a complete business case. Clear guidelines and a timetable must be set up at the outset. The size of the enterprise, the complexity of the supply chain and the activities eligible for outsourcing will determine the size of the team, the inherent skills and experience of the team members and time made available.

1.2 The usual reasons

The reasons for outsourcing a company's logistic operations are the same as for the outsourcing of any business functions e.g. finance, IS/IT, payroll etc. etc. The most common ones are:

- Costs
- Core competency
 - Skills
- Labour relations
- Investment priorities
- Merger, acquisition or take-over
 - Legislation
- Competitor actions

or a combination of a number of these.

1.2.1 Costs

This is the most common reason why companies outsource. Logistics service providers are more efficient, can flex resources with complimentary contracts to minimise costs and have networks into which the client can slot. Thereby delivering opportunities to cut costs and improve efficiency.

But the perceived absence of cost reductions is also the most common complaint from companies who have outsourced and have subsequently been disappointed with the performance of the service provider. There are a number of reasons for this disappointment.

Companies that manage and operate their supply chain internally often do not allocate all the relevant costs to this function. For example owned assets such as warehouses and vehicles are depreciated at rates which do not reflect market rates for lease or rent. Overhead costs such as IS/IT, HR and management time/costs tend not to be fully allocated. Thus internal logistics costs are often understated and the current partial cost view serves as a poor benchmark to calculate savings.

When moving to an outsourced operation, transfer and initial start up costs can be comparatively high. These costs are often not fully documented prior to the outset of the new operation. These costs need to be separated from the true long term costs.

Another reason for the apparent lack of cost reductions may be in the pricing structure agreed in the contract with the service provider. 'Cost creep' is a common failing with open book contracts (see section 2.1.6). Furthermore in a system of bonuses and penalties, it is often easier to deliver bonuses, than to extract penalties.

Finally a like-for-like comparison is often difficult to achieve, particularly in an environment of change, where volumes may be growing, new products launched and new markets opened.

1.2.2 Core competency

Companies often argue that their core competency is in areas other than logistics. Logistics is often seen as a necessary evil, an unavoidable cost of doing business, similar to Finance, IS/IT, and HRM. Concentrating finite time and money on the key areas of manufacture, selling, brand management, R&D etc is seen as a more profitable strategy.

This might appear to fly in the face of oft-stated maxim, that an efficient and cost effective supply chain may be a source of competitive advantage in its own right. But the latter does not have to be internal.

By outsourcing its logistics operations a company can concentrate their time and money on those areas where they can add real value.

But outsourcing should not mean a total abrogation of responsibility towards this area. Your supply chain may now be operated and managed by a third party, but who is going to manage the third party, both in transition and in steady state. Who is responsible for the integration of logistics strategy into the overall corporate strategy. A certain amount of management time will still be required to be spent; indeed a new set of skills may have to be acquired.

1.2.3 Skills

Another argument is that most companies do not have the requisite internal skills to operate or manage a complex supply chain. Particularly in a fast changing environment, where new ideas, technologies and pressures are constantly impacting on the chain.

This is often one of the most valid arguments. But companies must not confuse skills with knowledge and experience. Internally there will be a massive bank of detailed knowledge and experience directly relevant to the business of the client company. Any outsourced operation will require this to be part of an education programme to the third party service provider. Furthermore the service provider will take some time understanding the business dynamics between the logistics function and other functions such as commercial, procurement, production etc.

1.2.4 Labour relations

This reason is now much less prevalent than 10-15 years ago, when concerns over poor labour relations or inefficient practices were often the reason for companies looking to outsource. However there can still be valid labour reasons to outsource, especially in the area of flexibility.

But before embarking on this route you will need to ensure that you have a solid understanding of all relevant social legislation in the country(s) concerned, or seek external advice. A clear appreciation of all inherent costs and an agreement of cost apportionment are essential.

1.2.5 Investment priorities

Internal distribution assets tend to have a low rate of return compared with other investment opportunities. Also the sale of existing logistics assets might give a one-off positive impact on the cash flow.

As business grows existing supply chain assets will become out-dated and a block to growth. An ageing vehicle fleet requires increased maintenance costs and ultimately renewal. Existing storage facilities become too small, lack flexibility or are incorrectly sited. The systems controlling the movement of product no longer provide the proper interfaces with the rest of the business.

Rather than use finite investment capital to solve these problems, outsource to a third party. But get your finance team to run the figures first and be part of the contract negotiations. Understand your and the third party's cost of capital, depreciation policies etc. It is not unknown for short-term financial benefits to be out-weighed by longer term operating fees.

If you have developed a large highly complex supply chain, to achieve a fully integrated system can require some comparatively expensive IS/IT. Such investments may be beyond the budget of many Logistics Service Providers, nor will many be prepared to take the inherent investment risk. Thus if you decide to go ahead and outsource, you may have to accept less than a perfect solution.

1.2.6 Merger, acquisition or take-over

M&A activity often results in an increased drive to outsource. One of the parties may already have outsourced their supply chain. The new corporation may well be substantially different than just the sum of the two parts and this can have a significant impact on outsourcing requirements and operations. It should not be automatically assumed that the combined supply chain is just a question of size and volume.

A team should be established to undertake a full review of the supply chain and outsourcing options. Most third party logistics contracts have a clause in them relating to client mergers and acquisitions, often with a get-out clause.

1.2.7 Legislation

Increasingly national and international legislation is having an impact on the supply chain. The incorporation of such legislation into national law can provoke companies to outsource operations.

Some obvious examples include the Working Time Directive and drivers' hours, which could have a tremendous impact on internal fleet transport costs. The impending legislation on waste disposal in the electronics industry may also result in increased logistics costs in the area of reverse logistics.

There is little doubt that we will see increased legislation on congestion, road tolls, health and safety, environmental and social issues. Much of this will add to the costs of the supply chain and increase the likely benefits of outsourcing to a third party better positioned to absorb or ameliorate such cost increases.

1.2.8 Competitor actions

Finally some companies, with or without some benchmarking initiatives, see their competition outsourcing their supply chains and therefore determine that they must follow suit.

Do not be a slave to fashion! Try to establish why your competitors took such action. Has it been a success? What lessons can be learnt? Talk to them or to consultants. It is surprising what you can find out without too much effort

1.2.9 Other points

As part of preparing the ground, it is worthwhile understanding what sort of company you are.

- Cost-focused
- Customer-driven
- Centralised
- De-centralised
- Consensus-orientated
- Command and control
- Employee-focused
- Values-driven
- Production-led
- Sales-led
- Environmentally-acute
- Seasonally sensitive

The reasons for outsourcing and the company type will have a tremendous impact on the way forward and the ultimate goals, third party choice criteria and success factors.

One reason NOT to outsource is *'the present supply chain is not performing as required/anticipated, so let's give the problem to someone else to solve'*

There is no guarantee that this action will solve an inherent problem or problems. You must understand what are the causes of the problem first, otherwise you are just transferring problems to a third party and the underlying causes still have to be addressed. Indeed the causes might lie outside the narrow definition of the supply chain. They might be due to poor interfaces with production or poor communications between sales, forecasting and inventory management. In either case outsourcing will not solve the problems.

Supply chain management is not limited to the standard logistics activities of transport, warehousing and inventory control. It can involve the whole spectrum of business activities, through production, procurement, marketing, selling, forecasting, demand capture etc. etc.

Key to successful outsourcing is a real understanding of the existing 'as-is' situation, warts and all.

But what ever the reason(s) behind your decision to consider outsourcing – Remember different reasons require different approaches and evaluation criteria

1.3 What will be outsourced?

Having clearly articulated the reasons for outsourcing, agreed on your company type and produced a rigorous analysis of the 'as-is' situation, the next decision is to determine which part or parts of your supply chain you wish to outsource. This is the well-known choice of 'big bang' or 'incremental stages'. The pros and cons of each approach are well documented elsewhere.

To help make a decision you might consider examples in other industries or companies, external advice and internal experience.

There are plenty of examples of both approaches, but it is probably true to say that for the company considering outsourcing for the first time, incremental is preferable. It is common for organisations to first hand transport operations to a third party, then warehousing, then some of the international movements and so on. Arguably once you have commenced the process of outsourcing, you should not stop halfway through. A supply chain partly managed and operated by both internal and external parties is a recipe for discord and likely failure.

To assist in this decision you must have a clear and comprehensive definition of your supply chain and the dependencies and linkages within your business.

Also there must be a clear view of the end game and milestones to get there.

But remember to be flexible, unanticipated events and surprises await the most careful and conscientious of organisations.

1.4 What experience do we have

Even though a company may be embarking on a supply chain-outsourcing project for the first time there are chances that some person(s) within the organisation has prior experience of outsourcing the supply chain with another company. Or perhaps another business function has already been outsourced. Always make sure you use all existing knowledge and experience. If there is no internal experience the case for a consultant to assist is very strong.

1.5 Building a business case

Reasons for outsourcing are clear and agreed, the benefits well-articulated, internal experience captured, external support is in place. This now needs to be put together in a business case.

The team charged with preparing the ground only completes its role with a business case that is signed off (or dismissed) by senior management.

Decisions need to be made regarding the compilation of the Business Case:

- Who needs to be involved in preparing the business case?
- Whose opinions will be sought?
- What is the communications policy?
- Who sees the business case?
- What is the budget?
- Where is the timetable?
- If we go ahead, what are the roles, responsibilities and authorities? How will we maintain motivation during transition?

The acceptance of the business case and the decision to commence a programme of outsourcing is a major step and arguably a Change Management Programme. And the majority of Change Management Programmes fail!

1.6 Change Management

So why do so many Change Management Programmes fail? –

- Lack of senior management ownership
- Lack of buy-in from a significant number of the stakeholders
- No, or the wrong 'Champions of Change'
- Lack of a compelling Business Case
- Lack of a clear and comprehensive Plan
- Or it's the wrong Plan
- Too long an implementation
- Short term imperatives interrupt or disrupt longer term objectives
- Lack of understanding of the impact on other parts of the organisation
- One of too many concurrent initiatives
- Jumping from a burning platform
- Over or under exaggerated benefits
- Lack of detailed process mapping
- Lack of careful risk analysis of both the solution and its implementation

All this needs to be taken into account when preparing the ground.

1.7 A history of failure

A recent survey conducted by Cap Gemini, Ernst & Young and Accenture showed that the percentage of customers regarding the outsourcing of their logistics operations to a third party service provider as successful had fallen to 54%. In other words almost half the companies contacted were dissatisfied with the services of the Logistics Service Provider used.

Furthermore only 40% of third party logistics contracts are renewed.

The most frequently cited reasons for this apparent level of dissatisfaction are:

- Service level commitment not met
- 'Cost creep' and price increase after start of contract
- Lack of continuous improvement efforts
- Lack of consultative and strategic management skills
- Targeted direct and indirect cost savings not achieved
- Unsatisfactory transition during implementation stage

Much of this can be directly traced back to failures at the beginning of the whole process. A well prepared and researched business case, followed by realistic objectives, a clear appreciation of current operations and issues and a clear and comprehensive Invitation to Tender can go along way in ensuring satisfaction and success for all the stakeholders.

1.8 Measuring success

What will 'good' look like? A clear and well-communicated set of objectives and corresponding measurements are critical.

Before entering into any outsourcing agreement make sure you have clearly articulated how you intend to measure performance, what are the critical success factors and what is the associated time frame.

Remember that all objectives and success factors should be SMART, i.e. Specific, Measurable, Achievable, Realistic and Timebound.

Also be flexible, circumstances and events change and sometimes this may impact on your aims and objectives, changing priorities and issues.

1.9 Checklist

- Has a compelling Business Case for outsourcing been made?
- Who has ownership of the Project?
- Have the key stakeholders been involved?
- Are we convinced by the reasons given for outsourcing?
- Have we used all relevant and available internal experience?
- Will the use of outside consulting add value?
- Have other departments been involved in the thinking and decision process?
- Have we clearly defined our supply chain?
- Have we determined which part(s) of the supply chain to outsource?
- Have we fully costed and described the 'as-is' situation?
- Have we aligned our 'Company type', reasons to outsource and success criteria?
- Is our business stable or in flux?
- Are we just looking to transfer a fundamental problem(s)?
- Is time an issue?
- What will 'good' look like?
- What are the risks?

Once all the questions have been correctly answered, you can proceed to the next phase – preparing an Invitation to Tender.